

VZCZCXRO9364

RR RUEHDBU RUEHNL RUEHSK RUEHVK RUEHYG

DE RUEHYE #0380/01 1541353

ZNR UUUUU ZZH

R 031353Z JUN 09

FM AMEMBASSY YEREVAN

TO RUEHC/SECSTATE WASHDC 9134

INFO RUCPDOC/USDOC WASHDC

RUEATRS/DEPT OF TREASURY WASHDC 0642

RUCNCIS/CIS COLLECTIVE

RUEHAK/AMEMBASSY ANKARA 1785

RUEHIT/AMCONSUL ISTANBUL 0796

RHEHNSC/NSC WASHDC

RUEHLMC/MILLENNIUM CHALLENGE CORPORATION WASHINGTON DC

UNCLAS SECTION 01 OF 03 YEREVAN 000380

SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [ETRD](#) [KTDB](#) [AM](#)

SUBJECT: ARMENIA - MACROECONOMIC OVERVIEW FOR FIRST QUARTER 2009

REF: A) Yerevan 151 B) Yerevan 281

YEREVAN 00000380 001.2 OF 003

## SUMMARY

-----

¶1. Armenia's GDP declined by 6.1 percent in the first quarter of 2009 and 9.7 percent in the first four months. All economic indicators for the first quarter indicate that the Armenian economy is suffering a deep contraction, with negative growth figures in almost all sectors. Hardest hit have been the construction and mining sectors. The IMF forecasts a five percent drop in GDP for 2009, while the projections of the Ministry of Finance are more pessimistic, closer to 10 percent. End Summary.

## GDP DECLINES

-----

¶2. The Armenian economy contracted by 6.1 percent in the first quarter of 2009 to AMD 465.5 billion (USD 1.3 billion) compared to the same period in 2008. The main factors contributing to the drastic decline in GDP include a 21.9 percent decrease in construction and a 9.5 percent contraction in industrial output. The Central Bank of Armenia (CBA) forecasts that the Armenian economy will shrink 5.8 percent in 2009. According to an official from the Ministry of Finance, their forecasts are more pessimistic, according to which the GDP will fall by around 10 percent (Note: On May 20 the GOAM announced that Armenia's GDP for the first four months of 2009 declined by 9.7 percent. The GOAM released only limited information about April. End Note).

¶3. Armenia's industrial output fell by 9.5 percent in the first quarter compared to the same period in 2008. The mining industry declined by 11.4 percent, manufacturing by 8.8 percent, and energy sector declined by 10.6 percent, due to reduced demand for energy from other industrial sectors. Food processing and metallurgy, the two largest manufacturing sectors, recorded a slight growth of 3.3 percent and 2.1 percent respectively. Chemical production decreased by 61.9 percent, manufacturing of non-metallic mineral products by 25.8 percent, jewelry production by 58 percent.

¶4. The construction sector, which began contracting last fall, fell by 20.5 percent in the first quarter of 2009, due to reduced capital inflows and decreased private demand. The downturn is particularly visible in Yerevan, where nearly all construction projects are on hold mainly due to lack of financing. In an effort to boost the sector, the GOAM made a decision in May to provide USD 54 million in financing guarantees to encourage banks to lend to developers of projects that are at least 75 percent completed.

¶5. The agricultural sector reported a five percent drop in the first quarter. Expansion in the services sector slowed to 2.1 percent in

the first quarter due to reduced trade volumes. Trade of motor vehicles was down by about 50 percent. Communication services reported a 3.4 percent growth, while the volume of freight forwarded declined by 11.1 percent. The financial services sector contracted by 1.1, compared to 25.6 percent growth in the same period in 2008.

#### INFLATION WITHIN THE TARGET RANGE

---

16. The Board of the Central Bank of Armenia (CBA) lowered the refinancing rate by 0.25 percentage points in April to 7.5 percent, based on March inflation which was equal to 1.4 percent (Note: On June 2 the CBA announced a reduction of the refinancing rate to 6.25 percent, noting a 2.3 percent inflation rate for the first four months of 2009. End Note). Despite sharp depreciation of the Armenian Dram in March, inflation has been lower than projected due to a persisting external deflationary environment and declining domestic demand. Compared to December 2008, foodstuff prices were up by 0.3 percent, while prices of non-foodstuffs and services increased by 1.4 percent and 1 percent respectively. In March the prices for gasoline and diesel fuel increased by 9.1 percent and 5.7 percent respectively compared to February. Average import prices in March were up by 14.6 percent and export prices fell by 25.6 percent compared to December 2008.

#### EXCHANGE RATE STABLE

---

18. After sharp depreciation of the Armenian Dram in March by around 25 percent, from AMD 307 per dollar to AMD 380-390, after the CBA stopped intervening in the forex market (reftel), the exchange rate seems to have stabilized. The AMD currently trades at approximately

YEREVAN 00000380 002.2 OF 003

375 per USD. While speculation persists that that AMD is set for another major decline, there is no discernible movement in the exchange rates and the CBA consistently denies any forex intervention except to smooth large fluctuations.

#### UNEMPLOYMENT ON THE RISE

---

19. According to official statistics, Armenia's unemployment rate reached 6.7 percent in March, a 0.3 percentage point increase compared to March 2008. Over the past 12 months the number of registered unemployed has increased by 2.9 thousand reaching 76.1 thousand. The actual unemployment rate, however, is likely much higher. Household surveys regularly estimate unemployment at closer to 25 percent, not including those working abroad. While the Armenian Migration Agency does not have a precise number of returned migrant workers, the decline of Russia as a foreign work destination has resulted in an estimated thirty to forty thousand persons who will be obliged to stay in Armenia.

#### REAL WAGES AND INCOMES AFFECTED

---

110. According to official statistics in March, nominal wages increased by 16.5 percent in AMD and decreased by 1.7 percent in USD compared to March 2008. Despite the moderate inflation figures and increase in nominal wages reported in the official statistics, real wages and incomes of the population have deteriorated, due to the sharp depreciation of the AMD in March, higher prices for imported goods (15-30 percent, for selected products) and reduced remittances.

#### REMITTANCES

---

111. Armenia's economy is highly dependent on remittances from abroad, which have been steadily increasing since 2000. In the first quarter of 2009, non-commercial transfers to Armenia (through the banking system) declined by 32.1 percent compared to same period in 2008. The sharp decline in remittances, which constituted around 15

percent of the GDP in 2008, is explained primarily by unfavorable developments in the Russian economy, the main source of Armenian remittances (around 80 percent of total remittances). (Note: In recent meetings around the country, we have been told that remittances have declined by up to 80 percent compared to last year. End Note).

#### FOREIGN TRADE TURNOVER DOWN

---

¶12. Armenia's foreign trade turnover declined by 27.7 percent in the first quarter of 2009, amounting to USD 781.9 million at current prices. Exports registered a sharp decline of 47.3 percent compared to the same period in 2008, totaling USD 123.4 million. Imports declined by 22.2 percent to USD 658.5 million. The CBA expects a 30-35 percent decline in imports in 2009, mainly determined by real exchange rate revision and reduction of incomes in the domestic economy. Exports are projected to decline 25-30 percent, due primarily to reduced export prices. The decrease of real volumes of export of goods and services is projected to be 1-3 percent.

¶13. Armenia's main trading partners remained Russia, Germany, China, and Ukraine. Trade with EU countries (accounting for 30 percent of Armenia's total trade) declined by 43.8 percent. Trade with CIS countries (34.8 percent of total trade) declined by 23.9 percent. Exports and imports to Russia, Armenia's main trading partner, declined by 58.2 percent and 18.3 percent respectively. Exports of base metals, Armenia's main export item (37 percent of total exports), declined by 47.8 percent. Exports of precious and semi-precious stones and metals (20 percent of total exports) fell by 33.7 percent. Exports prepared food and mining products also declined by 50.9 percent and 55.8 percent respectively.

#### BUDGET REVENUES

---

¶14. Overall budget revenues declined by 9.7 percent--to AMD 139.8 billion (USD 378 million)--in January to March. Tax proceeds, which comprise around 74 percent of total budget revenues, fell by 16.7 percent. VAT collections, the main source of financing for the Armenian budget, were down by 20.1 percent to AMD 51 billion (USD 138 million) and corporate tax proceeds fell by 20.8 percent to AMD 15.9 billion (USD 43 million). Budget expenditures for this period amounted to AMD 153.5 billion (USD 415 million), a 10.4 percent increase compared to the first quarter of 2008, which drove the

YEREVAN 00000380 003.2 OF 003

budget deficit to AMD 13.6 billion (USD 36.8 million). To ease the pressure on the budget in the face of decreased revenues, the GOAM made a decision to defer expenditures of AMD 93 billion (USD 250 million) to the fourth quarter, or possibly eliminate them entirely.(Ref B)

#### COMMENT

---

¶15. The global financial crisis is taking a serious toll on Armenia, and with each month it appears to be deepening. We expect the second quarter performance to be worse than the first. The GOAM has attempted a number of countercyclical anti-crisis measures, and has borrowed over USD 1 billion from the World Bank, IMF and Russia in order to close budget gaps and engage in stimulus spending. While the GOAM must undertake some fiscal and monetary policy measures to counter the crisis, if it does not use this assistance prudently, Armenia will end up with much higher foreign debt and the economy in deep contraction. END COMMENT.

YOVANOVITCH